

Revised Local Agency Investment Guidelines

(Updated as of
January 1, 2000)



STATE OF CALIFORNIA

Philip Angelides
State Treasurer and Chair

CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

915 CAPITOL MALL, ROOM 400
P.O. BOX 942809
SACRAMENTO, CA 94209-0001
TELEPHONE: (916) 653-3269
FAX: (916) 654-7440

Hugo López
Executive Director

January 28, 2000

Dear Friends and Colleagues:

On behalf of the California Debt and Investment Advisory Commission (CDIAC), I am pleased to release the report "*Local Agency Investment Guidelines*," which has been revised to reflect statutory changes as of January 1, 2000. This report updates the previous *Guidelines*, providing current information on Government Code sections that affect the daily investment practices of California local agencies.

The original *Guidelines* were developed in 1996 as an interpretive document to aid local officials in their efforts to implement the numerous law changes that came about as a result of the Orange County investment pool bankruptcy. It has served as a valuable resource for local officials to answer questions related to the types of allowable investments, investment policy and portfolio reporting requirements, and the development of oversight committees.

Because the report is considered a "living" document; that is, one that officials can use daily to reference information critical to their jobs, it is important that it be as up-to-date and accurate as possible. The revised *Local Agency Investment Guidelines* accomplish this goal. It reflects statutory changes that have occurred through January 1, 2000, thus providing current and useful information to promote continued best investment practices by local government officials.

Reports such as this one, in combination with other information and educational resources, play a crucial part in CDIAC's mission to provide education and technical assistance to local officials. I welcome your comments and input on the important work and common goal of protecting Californians' tax dollars.

Sincerely,

Philip Angelides
State Treasurer and Chairman,
California Debt and Investment Advisory Commission

CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

The California Debt and Investment Advisory Commission was created in 1981 to assist state and local governments to most effectively and efficiently issue, monitor and manage public debt. In 1995, the Commission's responsibilities were expanded to include a municipal education program to help local governments to safely and effectively invest public funds. To carry out its responsibilities, the Commission maintains a database of all public debt issued in California, conducts a continuing education program, publishes a monthly newsletter with debt issuance data and informative articles, and conducts research to develop reports, guidelines and briefs on topical issues related to public debt issuance and investment practices.

Philip Angelides

California State Treasurer and Chairman

Gray Davis

Governor

or

Tim Gage

Director

Department of Finance

Kathleen Connell

State Controller

Wesley Chesbro

State Senator

Hilda Solis

State Senator

Louis J. Papan

State Assemblyman

Scott Wildman

State Assemblyman

Susan Leal

Treasurer

City & County of San Francisco

Vacant

Local Finance Officer

Hugo López

Executive Director

Additional information concerning this report or the programs of the California Debt and Investment Advisory Commission may be obtained by calling (916) 653-3269 or by visiting the Commission's website at <http://www.treasurer.ca.gov/stocda.htm>.

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INTRODUCTION

The aftermath of the Orange County investment pool failure and bankruptcy filing in December 1994, prompted numerous reports, special hearings, and committees to assess what went wrong and suggest measures to avoid similar problems in the future. Most notably, the Governor convened the Task Force on Local and State Investment Practices, chaired by the State Treasurer, to review the situation and recommend investment guidelines to the California Legislature. It was comprised of representatives from various statewide organizations and members of the Legislature.

The Task Force and other members of the state investment community prepared and presented to the Legislature a package of legislative proposals to improve investment practices of local agencies. These activities culminated in the California Legislature's enactment in late 1995 of numerous changes to the Government Code that restricted permissible investments and promoted oversight procedures for the management of public funds.

There was widespread support for the objectives of these new investment laws; however, many local officials expressed uncertainty over their implementation. To address these concerns, in 1996, the then-California Debt Advisory Commission (the "Commission") brought together a "working group" consisting of staff from the California Legislature and representatives from seven statewide associations to prepare what became the Commission's *Local Agency Investment Guidelines* (the "*Guidelines*"). The participating associations included:

- Association of California Water Agencies
- California Association of County Treasurers and Tax Collectors
- California Society of Municipal Finance Officers
- California Municipal Treasurers Association
- California Special Districts Association
- California State Association of Counties
- League of California Cities

The *Guidelines* were developed as an interpretive document meant to aid local officials in their efforts to implement the new laws. Since the original report's release in 1996, a number of additional statutory changes have occurred, including the addition to CDAC's mandate the responsibility of providing investment education and research. The Commission's name also was changed to the California Debt and Investment Advisory Commission (CDIAC). In keeping with its expanded mandate, CDIAC has revised these *Guidelines* to include statutory changes that have occurred since 1996 in order to provide local agency investment officials and interested parties with the most accurate, up-to-date information available. The information reported in these *Guidelines* reflect statutory changes effective as of January 1, 2000.

This updated document retains much of the same format as the original document; that is, it briefly describes each of the issues considered and offers a description of the minimum legal requirement for compliance with each section of the law. These descriptions represent the best judgment of the investment professionals involved, and are intended only as guidance for local agencies in their efforts to comply with the laws. The document also retains the working group's consensus recommendations from the original *Guidelines* where appropriate. Local agencies are advised, however, to rely only upon their legal counsel for legal advice.

The *Guidelines* are divided into four chapters:

Chapter I.	Annual Investment Policy
Chapter II.	Fund Management
Chapter III.	Reporting Requirements
Chapter IV.	Treasury Oversight Committees

There is one issue that does not fit neatly into one of these four chapters, and this concerns the applicability of the statutory changes to different types of jurisdictions. Generally speaking, it was the consensus of the working group that all local agencies, regardless of their characterization, are subject to the reporting, fund management, and investment policy requirements. (Only county governments are subject to the county oversight committee requirements.) All of these requirements are contained in the same article of the California Government Code dealing with public investments. That article begins with Section 53600, which states:

As used in this article, "local agency" means a county, city, city and county, including a chartered city or county, school district, community college district, public district, county board of education, county superintendent of schools, or any public or municipal corporation.

Any jurisdiction that assumes it is not covered by these provisions should seek the advice of its legal counsel.

In addition, an investment policy and an investment report from two public agencies are provided as models in the Appendix. These are not intended to supplant verbatim an existing policy, but to encourage local agency finance professionals to consider different approaches to meeting the unique needs of their own agencies. The best investment policies and reports reflect the specific characteristics and circumstances facing an agency—such as the governing board's attitude toward risk, the level of staff investment expertise, the predictability of revenues and expenditures, and the task the agency is charged to perform.

Finally, the updated *Local Agency Investment Guidelines* provide valuable information on how to properly manage public funds; however, it is also important to note that nothing can substitute for proper education/training of local treasurers, investment officers, and members of the legislative body/advisory committees in the area of public investments. In addition to this report, CDIAC offers investment seminars to provide local officials with relevant information to

assist them with their responsibilities. CDIAC, under the chairmanship of State Treasurer Philip Angelides, also has worked with a broad variety of interested parties to promote best investment practices through legislation, through the establishment of a toll-free Hotline (1-888-CDIAC49) for local agencies to confer with CDIAC regarding questionable debt and investment practices, and through the creation of a *Treasurer's Alert!* publication to disseminate timely information on such practices and other issues of vital importance to promoting and protecting the public trust.

CHAPTER I. THE ANNUAL INVESTMENT POLICY

The investment laws require all local agencies to develop an annual investment policy that must be considered by the legislative body and any oversight committee of the local agency at a public meeting. A good investment policy drives the cash, treasury, and investment management functions of an agency. It serves as a guide for setting and achieving program objectives, defines rules and establishes benchmarks, and reduces the exposure to liability of both the investment staff and the governing board. Finally, it is also important to note that rating agencies pay close attention to an agency's investment policy and portfolio in determining its credit rating.

I. A. How should the annual investment policy be submitted to the legislative body? [Section 53646(a)]

Section 53646(a)(1) requires that a *county* government annually render to its board of supervisors and oversight committee an investment policy, which the board is required to review and approve at a public meeting. In addition, the board must review and approve any changes to the investment policy at a public meeting.

Section 53646(a)(2) requires that any *other* local agency annually render its investment policy to its legislative body and, if applicable, its oversight committee, which the legislative body shall “consider” at a public meeting. This raises questions about whether or not the policy should be adopted officially by the legislative body, and the time during the year that this “consideration” should take place.

Minimum legal requirement: The investment policy must be an agenda item at a public meeting of the agency's legislative body at some time prior to or during the year it covers. The board of supervisors of a county government must review and approve the investment policy and any changes to it at the public meeting. The law does not place the same specific approval requirements on other local agencies, nor does it specify when during the year that consideration or approval must occur.

Consensus recommendation: The investment policy should be thoroughly discussed by an agency's legislative and/or advisory body and approved by a vote of the legislative body, no later than the end of the first quarter of the year to which it applies. The reason it is important to have a vote is to give “teeth” to the investment policy by increasing its authority and legitimacy. The annual policy also should be in effect for the treasurer to produce the required first quarter report—which must state compliance with the annual investment policy.

I. B. What must be included in the investment policy? [Section 27133]

With the exception of county governments, the investment laws do not contain any provisions specifying what must be included in the investment policy of a local agency. County investment policies must contain:

1. A list of allowable securities and instruments, according to the law, and the maximum percentage and term of each type;
2. The manner of calculating and apportioning the costs of the overall investing, handling, and managing of funds;
3. Limits on the receipt of honoraria, gifts, and gratuities to the treasurer or oversight committee members;
4. Criteria for selecting brokers and dealers (including prohibitions against selecting any broker, dealer, or security firm within a 48 month period of making a campaign contribution exceeding the limitations contained in Rule G-37 of the Municipal Securities Rulemaking Board);
5. Criteria for considering requests to withdraw funds from the county treasury; and
6. Terms and conditions under which local agencies that are not required to deposit funds may deposit funds if they so choose.

The last two of the above elements directly refer to the duties counties have in maintaining a local government investment pool. However, it would benefit any agency to include the other four elements in its own investment policy. A sample guide to creating an investment policy published by the Municipal Treasurer's Association of the United States and Canada is included in the Appendix to give additional details on items to include in an investment policy. The Government Finance Officers Association also has a sample investment policy available for purchase.

I. C. What constraints can county pools place on voluntary depositors?

An area where questions commonly occur is how county pools should treat funds from voluntary depositors. Voluntary funds are often referred to as "hot money" because of the difficulty county treasurers have in predicting withdrawals of these funds. Failure to have adequate information on a depositor's cash flow can lead to unanticipated withdrawals and introduce potential liquidity problems.

Minimum legal requirement: State law does not require county pools to accept voluntary deposits.

Consensus recommendation: Allow voluntary deposits only under a clearly written contract or memorandum of understanding. This agreement should spell out the exact rules for participating in the pool and provide the county treasurer with reasonable predefined discretion to establish the frequency and amount of voluntary funds that can be removed from the pool at a particular time. Another option is to ban voluntary deposits altogether, if the county has confidence that other local agencies have reasonable investment alternatives.

CHAPTER II. FUND MANAGEMENT

For the investment of county funds in a county treasury, Government Code Section 27000.3 establishes the Board of Supervisors as a fiduciary that is subject to the prudent investor standard unless it delegates its investment duties to the county treasurer. For other local agencies' funds invested in the county treasury, the county treasurer serves as a fiduciary and is subject to the prudent investor standard.

Except as provided for in Section 27000.3, Government Code Section 53600.3 declares each person, treasurer, or governing body authorized to make investment decisions on behalf of local agencies to be a *trustee* and therefore a *fiduciary* subject to the *prudent investor standard*. These persons shall act with care, skill, prudence, and diligence under the circumstances then prevailing when investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing funds. Section 53600.5 further stipulates that the primary objective of any person investing public funds is to safeguard principal; secondly, to meet liquidity needs of the depositor; and lastly, to achieve a return or yield on invested funds (Government Code Section 27000.5 specifies the same objectives for county treasurers and board of supervisors).

Risk is inherent throughout the investment process. There is risk assigned to any investment activity as well as opportunity risk related to inactivity. Market risk is derived from exposure to overall changes in the general level of interest rates while credit risk is the risk of loss due to the failure of the insurer of a security. The market value of a security varies inversely with the level of interest rates. If an investor is required to sell an investment with a 5 percent yield in a comparable 7 percent rate environment, that security will be sold at a loss. The magnitude of that loss will depend on the amount of time until maturity.

Purchasing certain allowable securities with a maturity of greater than five years requires approval of the governing board. Part of that approval process involves assessing and disclosing the risk and possible volatility of longer-term investments.

Another element of market risk is liquidity risk. Instruments with unique call features, special structures or those issued by little known companies are examples of "story bonds" and are often thinly traded. Their uniqueness often makes finding prospective buyers in a secondary market more difficult and, consequently, the securities' marketability and price are discounted. However, under certain market conditions, gains are also possible with these types of securities.

Default risk occurs when the borrower is unable to repay the obligation. Generally, securities issued by the federal government and its agencies are considered the most secure, while securities issued by private corporations or negotiable certificates of deposit issued by commercial banks have a greater degree of risk. Securities with additional credit enhancements, such as bankers acceptances, collateralized repurchase agreements and collateralized bank deposits, are somewhere between the two on the risk spectrum.

The vast majority of portfolios are managed with a buy and hold policy. Investments are purchased with the intent and capacity to hold them until maturity. At times, market forces or operations may dictate swapping one security for another or selling a security before maturity. Continuous analysis and fine tuning of the investment portfolio are considered part of prudent investment management.

This strategy is not to be confused with heavy trading activity where securities are purchased with the intent to sell them before maturity at a profit or the use of leverage to enhance yield or compound the risk of this trading activity. This strategy requires guessing the future direction of interest rates.

The Government Code contains specific provisions regarding the types of investments and practices permitted after considering the broad requirement of preserving principal and maintaining liquidity before seeking yield. These provisions are intended to promote the use of reliable, diverse, and safe investment instruments to better ensure a prudently managed portfolio worthy of public trust.

II. A. Which investments are permissible? Which are prohibited? [Sections 16429.1, 53601, 53601.6, 53631.5, 53635, and 53684]

Government Code Sections 16429.1, 53601, 53601.6, 53631.5, 53635, and 53684 place a number of requirements on how and where public money may be invested. Figure 1 on page 9 provides a synopsis of the permitted securities and conditions for using them.

Prohibited investments include securities not listed in the above chart, as well as inverse floaters, range notes, interest only strips derived from a pool of mortgages (Collateralized Mortgage Obligations), and any security that could result in zero interest accrual¹ if held to maturity, as specified in Section 53601.6 and 53631.5.

¹ Zero interest accrual means the security has the potential to realize zero interest depending upon the structure of the security. Zero coupon bonds and similar investments that start at a level below the face value are legal because their value does increase.

Figure 1:
Allowable Investment Instruments Per
State Government Code (as of January 1, 2000)

Investment Type¹	Maximum Maturity	Maximum Specified % of Portfolio	Minimum Quality Requirements
Local Agency Bonds	5 years	None	None
U.S. Treasury Obligations	5 years	None	None
State of California Obligations	5 years	None	None
CA Local Agency Obligations	5 years	None	None
U.S. Agencies	5 years	None	None
Bankers' Acceptances	270 days	40 percent ²	Federal Reserve eligible
Commercial Paper—Counties	270 days	40 percent	A1/P1 rating
Commercial Paper—All Others	180 days	15 or 30 percent ³	A1/P1 rating
Negotiable Certificates of Deposit	5 years	30 percent	None
Repurchase Agreements	1 year	None	None
Reverse Repurchase Agreements	92 days	20 percent combined	None ⁴
& Securities Lending Agreements		of base value	
Medium-Term Notes	5 years	30 percent	A rating
Mutual Funds	N/A	20 percent ⁵	Multiple ⁶
Money Market Mutual Funds	N/A	20 percent	Multiple ⁷
Collateralized Bank Deposits	5 years	None	None
Mortgage Pass-Through Securities	5 years	20 percent	AA rating ⁸
Time Deposits	5 years	None	None
County Pooled Investment Funds	N/A	None	None
Local Agency Investment Fund (LAIF)	N/A	None	None

Sources: Government Code Sections 16429.1, 53601, 53635, and 53684.

¹Prior to January 1, 2000, county governments were subject to the same restrictions as all other local governments for purchases of commercial paper. In addition, prior to January 1, 2000, the Government Code did not include language referring specifically to investments in securities lending agreements.

²No more than 30 percent of the surplus funds may be in Bankers Acceptances of any one commercial bank.

³Limit is 15 percent unless dollar weighted average maturity of all commercial paper does not exceed 31 days, then 30 percent is allowable. Commercial paper issuers must be U.S. Corporations with total assets in excess of \$500 million. Purchases may not represent more than 10 percent of the outstanding paper of an issuing corporation.

⁴Reverse repurchase agreements must be made with primary dealers of the Federal Reserve Bank of New York and the securities used for the agreement must have been held by the issuer for at least 30 days.

⁵No more than 10 percent of the agency's surplus funds may be invested in any one mutual fund.

⁶Must receive the highest ranking by 2 of the 3 largest nationally recognized rating agencies or the fund must retain an investment advisor who is registered with the SEC (or exempt from registration), has assets under management in excess of \$500 million, and has at least 5 years experience investing in instruments authorized by the State Government Code Sections 53601 and 53635.

⁷Must receive the highest ranking by 2 of the 3 largest nationally recognized rating agencies or the fund must retain an investment advisor who is registered with the SEC (or exempt from registration), and has not less than 5 years experience managing money market funds with assets under management in excess of \$500 million.

⁸Issuer must have an A rating or better for the issuer's debt as provided by a nationally recognized rating agency.

Minimum legal requirement: Only those investments expressly authorized in the law are permissible. Investments not expressly authorized are prohibited.

Consensus recommendation: Include the list of permissible securities in the investment policy, and modify the list to meet the unique needs of each local agency. These modifications may include additional restrictions on the type and amount of specific authorized investments to reflect the risk tolerance of the agency.

II. B. When must the composition of investments contained in a local agency investment portfolio be in compliance with state law? [Section 53601]

The Government Code provides a description of the types of instruments permissible for local agency investment and specifies the quality and portfolio composition requirements for these instruments. Prior to 1998, state statutes did not specify a point in time for compliance with respect to the composition of portfolio investment instruments. This ambiguity resulted in several different interpretations of compliance with state law. Some local agencies established guidelines requiring composition compliance at all times. Other local agencies believed that their portfolios should meet Government Code guidelines only when a particular type of instrument is initially purchased, thereby negating their exposure to noncompliance should future market prices fluctuate or investments mature and alter their portfolios' composition. In 1998, legislation was enacted to clarify the required timing of compliance.

Minimum Legal Requirement: Where the Government Code specifies a percentage restriction on a certain category of investment, this share of the investment portfolio must be in compliance with state law at the time that category of investment is purchased. The law does not specify that the *entire* portfolio must be in compliance when new instruments are purchased. It also does not require “rebalancing” in the case where subsequent maturities, sales, withdrawals, or similar non-purchase activities result in the remaining portfolio having one or more of the categories of investment rise above the percentage restrictions applicable at the time of purchase.

II. C. Must bond proceeds be invested in code cited securities? [Section 53601(l)]

Section 53601(l) allows greater flexibility with respect to the types of investments that may be made with bond proceeds. Specifically, the law permits money from bond proceeds, obligations under a lease, installment sales, or other agreements of a local agency to be invested in any security that meets the statutory provisions governing the issuance of the bond or other agreements made by the issuing agency. In so doing, this section of the code recognizes that outstanding contracts between issuers and bond holders may not comply with the revised statute, and gives local agencies some greater discretion in how to invest bond proceeds.

Minimum legal requirement: Bond proceeds may be invested in accordance with the Government Code provisions, or they may be invested in alternative vehicles if authorized by bond documents.

Consensus Recommendation: The agency's investment policy should either require that bond proceeds be invested in accordance with the Government Code provisions, reference applicable bond documents, or specify the types of investments authorized for bond proceeds. Agencies should make sure that language in bond documents governing the investment of bond proceeds conform to specific provisions of the agency's investment policy, if any, addressing bond proceeds.

If bond proceeds are not addressed in an agency's investment policy and are invested in a manner that is outside the investment parameters for other agency funds, the investment report should note the difference and the authority for the difference (for example, bond documents).

<p>II. D. Are all US Agency bonds legal for investment by California local agencies? [Sections 53601(e) and 53635(e)]</p>

There has been a lot of discussion about the risky nature of certain products and derivatives issued by US Agencies. These agencies offer both traditional fixed-income securities (notes and bonds) as well as other more complex, often-customized products (including derivatives). The State's investment laws, however, place no restrictions on these types of investments other than the prohibitions against inverse floaters, range notes, interest-only strips derived from mortgage pools, and securities that could result in zero-interest accrual if held to maturity. Therefore, local agencies may invest in a range of securities, including derivatives, issued by US Agencies, such as the Community Development Corporation (CDC), Federal National Mortgage Association (Fannie Mae), Government National Mortgage Association (Ginnie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac), as well as obligations from the Student Loan Marketing Association (Sallie Mae), Small Business Administration (SBA), Tennessee Valley Authority (TVA), and other federal agencies or US government-sponsored enterprises (GSE).

Minimum legal requirement: Obligations, certificates of participation, or other instruments issued by a federal agency or a United States GSE are permissible investments, subject to the prohibition against inverse floaters, interest-only strips derived from a pool of mortgages, and securities that could result in zero-interest accrual.

Consensus recommendation: Local agencies should institute restrictions that recognize the different characteristics of US Agency bonds. Generally, the higher rates of interest that some of the more customized offerings provide can be overshadowed by lower levels of liquidity and higher levels of risk. Investments in these types of products should only be entered into with a

clear awareness, by both the legislative body and treasurer, of risks involved and only if the local agency's staff has sufficient expertise to manage such investments.

II. E. What are “medium-term notes”? [Sections 53601(j) and 53635(j)]

Amendments to Government Code Sections 53601(j) and 53635(j) have attempted to clarify some of the confusion surrounding the definition of “medium-term notes”. A variety of reasons account for this past confusion. One is that the SEC treats “corporate notes” slightly differently than “medium-term notes.” Another is that brokers often refer to corporate obligations that have an original term to maturity longer than 5 years as corporate rather than medium-term notes, even though the present term to maturity for these notes may be less than 5 years.

Minimum legal requirement: Government Code Sections 53601(j) and 53635(j) define medium-term notes as “all corporate and depository institution debt securities with a remaining maturity of five years or less.” Therefore, investments in any corporate or medium-term notes which mature within 5 years from the time of purchase are legal as long as they meet the minimum quality standards. Moreover, the Government Code specifies that local agencies may not classify investments as medium-term notes if they satisfy the definition of other allowable investments authorized under state law. For example, a local agency could not consider a security that satisfies the definition of commercial paper as a medium-term note in its portfolio.

II. F. What are the rules regarding the use of reverse repurchase agreements and securities lending agreements? [Sections 53601(i) and 53635(i)]

The intent of the investment laws in this area is to limit the opportunity for the imprudent use of reverse repurchase agreements (reverse repos) and securities lending agreements. In 1995, the Legislature, concerned about the use of reverse repurchase agreements for enhancing yield, imposed the following restrictions:

- Reverse repos cannot constitute more than 20 percent of the “base value” of an agency’s portfolio;²
- Reverse repos are limited to 92 days unless the minimum spread between the rate on investment and cost of funds is guaranteed in writing; and

² The base value of an agency’s portfolio is defined as the dollar amount obtained by totaling all cash balances in the portfolio from all sources, excluding any amounts attained from reverse repos or similar borrowing methods.

- Securities used to make reverse repos must be held for a minimum of 30 days prior to the transaction.

In 1999, Government Code Sections 53601(i) and 53635(i) were amended to include securities lending agreements. The restrictions described above also were extended to securities lending agreements with the exception that a local agency portfolio may not hold more than 20 percent of its base value in reverse repos and securities lending agreements combined.

Minimum legal requirement: Reverse repurchase agreements and securities lending agreements may be used to take advantage of certain short-term opportunities to increase yield as well as to resolve cash flow shortages, subject to the limits noted above.

Consensus recommendation: Reverse repurchase agreements should be used primarily for resolving cash flow shortages, and should be entered into only when there is a clear awareness by both the legislative body and treasurer of the risks involved, and when the agency's staff has sufficient expertise to manage such investments. The task force did not make any recommendations regarding securities lending agreements.

<p>II. G. What are the rules regarding the use of mutual funds and money market funds? [Sections 53601(k), 53601.6(b), and 53635(k)]</p>

Many have questioned the requirements regarding the types of mutual funds and money market funds that are eligible for investment. (Money market funds are also referred to as money market mutual funds in the law.)

Minimum legal requirement: The requirements for investing in these funds are explained in Figure 2 on page 14.

Figure 2:
Government Code Requirements for Local Agency Investment
in Money Market and Mutual Funds (as of January 1, 2000)

Conditions Allowing for Investment	Money Market Funds	Mutual Funds
I. Receive the highest ranking or the highest letter and numerical rating by 2 of the 3 largest nationally recognized rating services; or Retain an investment advisor who is registered or exempt from registration with the SEC and has at least 5 years experience investing in specified securities and managing assets in excess of \$500 million. ¹	X X	X X
II. Abide by the same investment restrictions and regulations that apply to public agencies in California [Section 53601 (a-j, m-n).		X
III. Follow regulations specified by the SEC under the Investment Company Act of 1940 (15 U.S.C. Section 80a-1, et seq.).	X	

¹The requirement for mutual funds is experience investing in securities and obligations authorized in Section 53601 and 53635 of the Government Code. For money market funds, it is experience in managing the types of investments that can be purchased by money market funds as specified in SEC Regulation 2a-7.

The important distinction made between these two types of funds is that money market funds are not subject to the specific limitations of California Government Code Sections 53601 and 53635 (a-j, m and n), while mutual funds are subject to those restrictions and local officials must verify their compliance prior to purchasing shares. Money market funds are governed by federal SEC regulations that specify diversification requirements and the types of securities that they may purchase. Money market funds are only authorized to invest in highly-rated, short-term debt instruments, but they may invest in certain ancillary agreements related to eligible securities (e.g., repurchase agreements, securities lending agreements, certain kinds of puts, etc.) that may carry a higher degree of risk. Because money market funds can only invest in securities with defined maturities, they cannot invest in equities or foreign currencies.

Consensus recommendation: The investment policy should specify criteria for selection of both mutual funds and money market funds by the investment official.

II. H. What are the rules affecting the use of tax and revenue anticipation notes (TRANs)? [Sections 53821.5, 53841.5, 53852.5 and 53859.02(b)]

Section 53821.5 and those listed above prohibit the investment of TRANs proceeds in securities that have terms exceeding those of the TRAN itself. In other words, proceeds from a TRAN due June 20 may not be invested in securities that mature after June 20. The intent of these Government Code Sections is to prevent agencies from using their TRANs proceeds to purchase long-term securities in order to achieve higher investment yields.

Minimum legal requirement: The minimum legal requirements are clear for securities that have an identifiable term to maturity. However, the law is ambiguous when an agency invests TRAN proceeds in items that do not have a specific maturity date, such as investments in county pools or other funds that may have an average maturity that is longer than the TRAN.

Consensus recommendation: TRAN proceeds can be invested in items that have no specific term to maturity so long as the proceeds can be removed within the period of the TRAN without a penalty. Therefore, liquid funds such as LAIF or county pools—where an agency has relatively quick access to its deposits—are legitimate investments for TRAN proceeds, as long as withdrawals are not restricted or penalized.

II. I. What is an appropriate safekeeping arrangement? [Sections 53601, 53608, and 53635]

Many officials have asked if the investment laws prevent the safekeeping of securities in a separate department or subsidiary of the company from which the securities were bought.

Minimum legal requirement: As long as the securities for safekeeping are in the name of or under the control of the agency and kept in a legally separate trust department, they can be held by the same firm from which they were purchased.

Consensus recommendation: Use a safekeeping service that is not related in any way to the company who sold the securities. Agencies should strive to “perfect” the delivery of securities purchased by avoiding situations where a relationship between the broker-dealer and safekeeping provider exists. Even in situations when the safekeeping function is in a subsidiary or trust department that is legally independent of its parent company, strong ties between the two may remain. In the event that the parent company fails, local agencies may have some difficulty in regaining possession of their securities from the subsidiary or trust department.

II. J. Does state law have an impact on the relationship between local agencies and outside investment management firms? [Section 53600.3]

Some officials are concerned that the State's investment laws may allow local officials to avoid any fiduciary responsibility for funds being handled by outside investment management firms. This reading of the law is not accurate. The intent of the law is for the legislative body and treasury of an agency to bear responsibility and liability for all surplus funds.

Minimum legal requirement: A finance officer or treasurer can delegate duties to an external money manager via a principal-agent relationship, but they cannot delegate authority or fiduciary responsibility.³

Consensus recommendation: Contracts with external managers should allow them to make specific decisions within an established framework. Treasurers should closely monitor the actions of these individuals to ensure they are consistent with the agency's investment policy and philosophy, and demand that external managers provide timely reports that comply with the requirements of state law.⁴

³ An official legal opinion by the Attorney General for the State of California issued in June 1996 that discusses the relationship between issuers and outside investment managers has been included in the Appendix.

⁴ A good source for more information about using money managers is the Government Finance Officers Association (GFOA) publication, *An Introduction to External Money Management for Public Cash Management*.

CHAPTER III. REPORTING REQUIREMENTS

Government Code Section 53646 requires all local agencies to file reports on the status of their investment portfolios with their respective legislative body, internal auditor, and chief executive officer.⁵ Agencies which deposit all of their funds in the county treasury, the local agency investment fund (LAIF) maintained by the State Treasurer, FDIC insured bank deposits, National Credit Union Shared Insurance Fund-insured accounts in a credit union, accounts insured or guaranteed pursuant to California Financial Code Section 14858, or some combination of the above, may substitute the most recent account statement received from those entities in lieu of the information on these investments that is otherwise required by this section. The report must be submitted within 30 days after the end of the quarter and include the following information:

- 1) Investment type, issuer, date of maturity, par value and dollar amount invested in all securities, and investments and monies held by the local agency;
- 2) A description of the funds, investments, and programs (including lending programs) managed by contracted parties;
- 3) A market value as of the date of the report and the source of the valuation;
- 4) A statement of compliance with the investment policy or an explanation for non-compliance; and
- 5) A statement of the ability or inability to meet expenditure requirements for six months, as well as an explanation of why money will not be available if that is the case.

The legislative body of the local agency may elect to require the report monthly and may receive additional information beyond that listed above.

III. A. Which investments need to be included in the report? [Section 53646(b)(1-4)]

The reporting requirement specifies that the report shall “include the type of investment, issuer, date of maturity, par and dollar amount invested on all securities, investments and moneys held by the local agency, and shall additionally include a description of any of the local agency’s funds, investments, or programs, that are under the management of contracted parties, including lending programs.”

Confusion exists as to the meaning of the words “held by the local agency.” Several standards have been suggested to clarify this phrase, including “ownership,” “control,” “under direct management by,” “possession,” and “accountability for the funds.” Each of these suggestions would lead to different determinations as to the specific funds required to be reported. The

⁵ AB 2845 also requires that reports and/or audits concerning investments that are prepared by county treasurers must be provided to local agencies that have funds deposited in the county’s investment pool.

apparent intent of the Legislature in enacting this requirement was to provide for comprehensive disclosure of local agency investments.

Minimum legal requirement: Include all of the securities, investments and monies for which the local agency **exercises control** or are **in its possession**. Control implies that the local agency has some discretion to determine how the funds are invested. Possession implies that the local agency has at least a safekeeping role. This standard ensures the broad reporting of local agency investments contemplated by the Legislature. Thus, the report should include the following items:

- surplus funds, whether invested directly by the agency or by a contract investment manager;
- locally managed pension funds;
- locally managed deferred compensation funds;¹⁶
- bond funds, because local agencies have the right to direct their investment; and
- endowments and other trust funds.

Under this standard, there are few exceptions to inclusion in the report. One exception would be for defeased bond issues, which are typically held and invested by trustees under a contract that precludes agency direction. Agency contributions to the Public Employees Retirement System (PERS) need not be included.

With regard to local agencies that have placed *all of their funds* in LAIF, insured accounts, or county investment pools, or any combination of these, the law provides that the most recent account statement received from these institutions may be substituted for the specific investment information generally required. The certification as to the agency's ability to meet its expenditure requirements and the statement of portfolio compliance to investment policy must still be provided.

The law also requires that the report include a description of funds that are under the management of contracted parties, including lending programs. This requirement is in addition to the specific reporting requirement discussed above, so that local agencies must provide information as to the type of investment, issuer, maturity, par and dollar amount invested just the same as locally managed investments.

Consensus Recommendation: Provide all information listed above. In addition, local agencies should generally describe the investments covered by such contracts, the name of the investment managers, and the nature of the contracts.

¹⁶ Most deferred compensation funds are held by third-party administrators and invested at the direction of program participants. HR 3448, the "Small Business Job Protection Act" (PL 104-188) passed in 1996, states that Section 457 deferred compensation monies are no longer considered assets of the employer if the employer establishes a trust to hold these funds. Once such a trust is established, these third-party administered deferred compensation funds would then be excluded from the investment report. In the case of local agencies that administer their own deferred compensation funds, however, they still would have possession of the funds and should continue to include them in the investment report.

III. B. How should market value be used in a portfolio? [Section 53646(b)(1)]

1) How should the market value of the portfolio be determined? The Government Code requires reporting the market value of the agency's portfolio. The National Association of State Treasurers (NAST) recommends that local entities obtain independent third party assessment of investments and risk. The most common, and often easiest, approach is to request pricing information from the agency's safekeeping service, custodial service, or trustee. Agencies may need to contract with pricing service companies for more complex securities. These companies specialize in giving the current market price for a broad range of securities.

An alternative way to determine the value of securities in a portfolio is to perform an in-house analysis by collecting information from different sources such as dealer quotes, on-line computer information, and certain publications that provide price estimates. These sources may not be as up-to-date or accurate as a pricing service, but they offer a relatively inexpensive method to make price estimates. Finally, to assess the worth of securities where specific prices are not available, a treasurer can either tie the spread of a recent investment to a benchmark security that is easy to value or use a matrix pricing formula. A matrix pricing formula displays the prices of a variety of different securities which are then used as a basis for approximating the value of the security in question.⁶

Minimum legal requirement: The market valuation data in the report should represent the agency's best available information and fairly represent the value of the portfolio, in the judgment of the investment officer.

Consensus recommendation: Obtain an independent valuation of the portfolio to provide the most unbiased method of reporting current market values. In situations where an agency's budget does not allow independent valuations, the agency should use the best available sources of market price information available. A system can be created to track prices from different sources over time to evaluate the sensitivity of price estimates, but there is no standard for accuracy. Prices for securities are estimates that carry a certain degree of error regardless of the approach used and they will fluctuate due to market conditions over time. It is imperative that local officials pay extra attention to estimates on complex, infrequently traded, or highly customized securities.

2) Can cost or par values be used in-lieu of market values? The legislation requires the determination of market value for securities in the local agency's portfolio. The intent of this requirement is to facilitate the review of the performance of each individual investment and the entire portfolio by policy makers. The focus of this review will be on the difference between "cost" and "market value," and the causes of the differences relative to market and individual security risk profiles. In some cases, the difference will be either negligible or nonexistent, and in others the difference can be significant.

⁶ Matrix pricing formulas are commonly used for short-term securities that mature between 90 and 180 days.

Minimum legal requirement: Limit the use of cost or par values to situations where market values cannot be readily obtained or estimated, but only when the cost or par value, in the judgment of the investment officer, represents an acceptable estimate of market value. Indicate that a cost or par value was used. There is a danger that cost or par values will dramatically under- or overstate the value of securities, such as is the case for securities with below-market coupons that were purchased at par.

Consensus recommendation: Utilize cost or par value only for narrowly-traded securities that are within six months of maturing and when reliable market value estimates are not readily available. Report the cost of the investment for certificates of deposits.

3) Should the report include market values for individual securities? The market value of each security in a portfolio must be computed before determining the portfolio's overall market value, but the law does not clearly require these individual values to be listed. Therefore, agencies may choose to provide either the market values of each holding or one aggregate market value of the entire portfolio.

Minimum legal requirement: Provide the total market value of the overall portfolio in the report.

Consensus recommendation: List the individual market value for each security in the report. This approach gives a more complete picture of the health of a portfolio and brings individual investment performance to the attention of those responsible for oversight. An agency concerned that listing detailed information about individual holdings may lead to second guessing and micro-management of the treasurer's decisions may choose to list an aggregate market value and append a footnote to the portfolio's overall market value stating that data on particular investments is available upon request.

<p>III. C. What issues should the local agency consider regarding the six-month expenditure and sufficient cash flow statements? [Section 53646(b)(3)]</p>

1) Does a cash flow analysis to support the expenditure statement need to be included in the report? A component of the report is the statement by the treasurer that the portfolio is liquid enough to meet expected cash flow needs over the next six months. The intent of the law is to insure that treasurers are prepared for upcoming obligations by requiring them to consider their projected cash flows. Although the expenditure statement is presumably based on the staff's knowledge of cash flow requirements, many local agencies do not provide any information beyond a brief qualifying statement that says "the treasurer believes the portfolio contains enough cash flow liquidity to meet the next six months of expected expenditures."

Minimum legal requirement: Include a statement saying that the projected cash flow is adequate to meet expected obligations over the next six months.

Consensus recommendation: Regularly prepare and update a cash flow analysis to justify the expenditure statement in the report. This analysis may list basic projections—based on historical data, market sensitivity or other relevant information—that support the cash flow liquidity statement. There are no guarantees when it comes to predicting future obligations. A sound justification for the expenditure statement gives the finance officer added protection against decisions that originally looked good but turned out poorly because of unforeseen circumstances. The treasurer should be prepared to discuss cash flow projections and methodology at the request of legislative and/or oversight bodies.

2) Must pool participants’ cash flow needs be considered in preparing the cash flow statement for an investment pool? Those who manage investment pools need to pay close attention to the needs and accuracy of the requests of participants to ensure accurate cash flow projections. Incomplete information about a pool’s investors not only compromises the legitimacy of the six-month cash flow statement, but also adds substantially to the liquidity risk of the pool.

Consensus recommendation: All participant’s cash flow needs must be taken into account in preparing the six month cash flow statement. Keep close tabs on mandatory and voluntary pool participants’ cash flow needs and establish clear criteria for the deposit and withdrawal of their funds. Obtain expected deposit/disbursement information from pool participants at the time of major fund deposits and/or updates of cash flow projections.

<p>III. D. Is it valuable to determine the portfolio’s weighted average maturity (WAM)? [Section 16481.2(b)(2)]</p>
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Weighted average maturity (WAM) measures the portfolio’s “average life” and is often used as an indicator of interest rate risk. The Government Code only requires the State of California to compute the WAM of all investments in its pool. Some local agencies, however, have inquired whether they also should include this information in their report.

Minimum legal requirement: Local agencies in California do not have to report WAM.

Consensus recommendation: Consider requiring the inclusion of WAM or similar alternatives (such as modified duration or convexity) in the report. Local agencies should also consider whether their investment policies should provide guidance on acceptable ranges for WAM. These figures trigger a number of valuable questions about the status of the portfolio for both internal and external purposes including liquidity, cash flow, and yield curve position (for example, how far out the portfolio is on the yield curve). An easy method for determining the WAM is to divide the sum of the days to maturity multiplied by the book value for each security by the total book value of the portfolio. Figure 3 on page 22 shows an example of how this is measured:

**Figure 3:
Calculation of Weighted Average Maturity**

Par Value	Security Description	Days to Maturity	Book Value	Days Multiplied by Book Value
\$1,350,000	Repurchase Agreements	1	\$1,350,000	1,350,000
\$5,000,000	Local Agency Inv. Fund	1	\$5,000,000	5,000,000
\$5,000,000	Fed Natl. Mtg. Assn.	185	\$4,886,108	903,930,041
\$5,000,000	Fed Home Loan Bank	550	\$5,000,000	2,750,000,000
\$5,000,000	US Treas. Note	720	\$4,985,156	3,589,312,500
\$5,000,000	Fed Natl. Mtg. Assn.	822	\$5,000,000	4,110,000,000
\$5,000,000	Fed Farm Credit Bank	910	\$4,988,941	4,539,936,255
	Total		\$31,210,206	15,899,528,796
WAM = [Summation (Days to Maturity Multiplied by Book Value)]/Total Book Value =15,899,528,796 / 31,210,206 =509 Days or 1.42 Years WAM				

III. E. How should the investment report be submitted to the legislative body? [Section 53646(b)]

1) What should the legislative body do with the report? The Government Code requires that the report be *rendered* to the legislative body within 30 days of the quarter's end. Questions have arisen as to whether the legislative body needs to discuss and approve the report during a regular meeting, have it placed on the consent calendar, or only receive a copy.

Minimum legal requirement: The law does not clearly require that the legislative body take any particular action in public session on the quarterly investment report.

Consensus recommendation: The legislative body of the agency should discuss the report as necessary, and take action on the report in public session. The report could be listed as a consent calendar item or as a non-consent calendar item, depending on the preferences of the legislative body. Possible actions of the governing body on the report could include: receiving and filing the report, approving or disapproving the report, with or without amendments; and/or asking staff for further information/clarification. In addition, investment advisory bodies should discuss the reports at their own meetings.

2) How should agencies address difficulties in meeting the 30-day requirement? It can be difficult for an agency to collect all the appropriate information for the report, have an oversight committee (if a jurisdiction has one) review and/or approve it, and present it to the legislative body within 30 days of the quarter's end. Various factors such as the length and diversity of the portfolio, size of staff, and computer software can influence the amount of time it takes to compile a report.

Minimum legal requirement: The law requires that the quarterly investment report be submitted to the legislative body within 30 days of the end of the quarter.

Consensus recommendation: A report, as complete as possible, should be submitted within the allotted 30 days. If current values for certain investments are not available within the time frame to complete the report in a timely fashion, submit the report on time and indicate in the report the most recent valuation and its date and then submit updated values to the legislative body at the soonest date possible thereafter. It should be available for individual legislative body members to review within 30 days of quarter end. This may include providing a copy to each member, including it in agenda materials for a public meeting or actually presenting the report at a public meeting of the legislative body.

CHAPTER IV. TREASURY OVERSIGHT COMMITTEES

The investment laws require any county that invests surplus funds to establish a treasury oversight committee. The function of the treasury oversight committee is to monitor and review the county investment policy by conducting or causing an annual audit and discussing their findings at a public meeting. The committee must consist of three to eleven members appointed from the following categories:

1. County treasurer.
2. County auditor, controller, or finance director as the case may be.
3. One representative selected by the board of supervisors and one selected by a majority of the school districts and community college districts.
4. County superintendent of schools or his/her designee.
5. A representative of special districts that are required or authorized to deposit funds in the county treasury.
6. Up to five other members of the public.

A majority of the public members of the committee shall have expertise in, or an academic background in, public finance. The other public members shall be economically diverse and bipartisan in political registration. Committee members cannot:

- a. Be employed by an entity that has contributed to the campaign of a candidate for the office of local treasurer;
- b. Be employed by an entity which contributed to the campaign of a candidate to be a member of a legislative body of any local agency that has deposited funds in the county treasury in the previous three years;
- c. Directly or indirectly raise funds for a candidate for local treasurer or a member of the governing board of any local agency that has deposited funds in the county treasury; and
- d. Secure employment with bond underwriters, bond counsel, security brokerages or dealers, or with financial services firms during the period that the person is a member of the committee or for one year after leaving the committee.

IV. A. What options are available for structuring the county treasury oversight committee? [Sections 27131 and 27132.1 through 27132.4]

The rationale behind the creation of an oversight committee is to give local agencies and private sector citizens a say in the policies governing the investment pool. Because of restrictions on

membership, however, counties often find it difficult to attract private sector citizens to serve. For example, the law prevents members from securing employment with bond underwriters, bond counsel, security brokerages or dealers, or with financial services firms during service on the committee or within one year after leaving the committee. Presumably this would allow those currently employed in the private sector to remain so, but would prevent any other committee member from securing employment in these fields. Read literally, this prevents committee members currently employed in these private sector fields from changing jobs for one year after leaving the committee.

Another restriction prohibits any committee member from making individual political contributions to, or being employed by an entity that makes political contributions to, or from doing any fund raising on behalf of, any candidate for office of the governing board of any agency that deposits funds in the county treasury. The legislation specifies that members of the committee can include six local elected officials. Many elected officials are politically active and participate financially in the campaigns of other local candidates and a literal reading could deny them the opportunity for committee membership.

**Figure 4:
Approaches to Establishing the County
Treasury Oversight Committee**

Various Options Available to Local Governments	
1.	A committee of both public and private sector members.
2.	A committee of public sector officials that has an advisory board made-up of private sector professionals and citizens.
3.	A committee that only consists of individuals who work for agencies that have funds invested in pool.

Consensus recommendation: Counties should decide for themselves if they want private sector individuals to serve on the county treasury oversight committee. If they do, then the county must either attract citizens who are willing to avoid seeking employment in the public finance industry or, if they are currently employed in that capacity, not to change jobs for one year after leaving the committee (see Figure 4, approach #1 above). A county can also solicit input from those who work in the private sector of public finance by establishing an advisory board to the county treasury oversight committee that has restrictions that are less stringent than those of the county oversight committee (see Figure 4, approach #2 above). If a county does not believe private sector input is important, they can limit membership on the oversight committee to those who work in the public sector (Figure 4, approach #3 above).

IV. B. Does the appointment of the treasurer to the county treasury oversight committee create a conflict of interest? [Sections 27131 and 27132]

Government Code Sections 27131 and 27132 do not specify whether or not the county treasurer should be a member of the oversight committee. Section 27132 specifically lists the county treasurer as a potential member of the county treasury oversight committee. Since the committee's central task is to oversee the treasurer's policies, some believe that allowing the treasurer to sit on the oversight committee represents a conflict of interest. Others claim that treasurers who donate money to their own campaign cannot be on the county treasury oversight committee because the law forbids membership to those who contribute to the campaign of someone running for treasurer while serving on the committee. In addition, any person, including any elected official, who serves on the county treasury oversight committee would be prohibited from seeking employment with the financial services industry for one year after leaving the committee.

Consensus Recommendation: The question of whether or not a county treasurer should sit on the treasury oversight committee must be made by the county board of supervisors and the treasurer. Their answer should consider the advantages and disadvantages of having someone with the treasurer's influence and expertise sit on the committee and the future employment implications to the treasurer. It should not in any way hinge on whether or not a treasurer donated money to his/her own campaign.

Contributing money to one's own campaign, or contributions from one elected official to another elected official, does not represent a legitimate conflict of interest in the context of the treasury oversight committee.

IV. C. What is the role of the county treasury oversight committee? [Sections 27134 and 27137]

Government Code Sections 27134 and 27137 limit the oversight committee's functions to monitoring and reviewing the county treasury's compliance with the investment policy and reporting provisions of the law through an annual audit. These provisions address concerns that individuals serving on the treasury oversight committees may try to micro-manage decisions that should be left to the treasurer. Considerations by the committee regarding the risk and structure of a portfolio are permitted in the law; however, any attempts to direct individual investment decisions, select individual investment advisors, brokers, or dealers, or impinge on the day-to-day operations of the county treasurer are forbidden.

Consensus recommendation: Clearly stipulate the responsibilities of the treasury oversight committee and keep them focused on policy issues.

IV. D. Should other local agencies have treasury oversight committees?

It is not uncommon to find treasury oversight committees in cities and other local agencies even though the law does not require them to have such a committee. An important issue in the decision to establish a committee is the level of discretion accorded the agency treasurer in making investment decisions. The more discretion, the greater the need for oversight procedures. However, even in situations where an agency has a great deal of discretion, some believe an oversight committee merely duplicates work that can be better performed by the governing board and/or auditors. Others support the view that an oversight committee provides valuable information to the investment staff and involves members of the community in an important government function. If other local agencies decide that they want to engage an oversight committee, its role with respect to reviewing investment policies and quarterly investment reports should be clearly specified.

Minimum legal requirement: Only counties are required to have the oversight committee.

Consensus recommendation: Each agency should consider for itself if an oversight committee is appropriate based on its current oversight procedures, complexity of its portfolio, frequency with which it purchases securities, and skill level of its staff. The limitations and restrictions associated with county treasury oversight committee members do not apply to committees formed by other local government entities.

GLOSSARY

Arbitrage—Transactions by which securities are bought and sold in different markets at the same time for the sake of the profit arising from a yield difference in the two markets.

Bankers' Acceptance—A draft or bill or exchange accepted by a bank or trust company. The accepting institution, as well as the issuer, guarantees payment of the bill.

Bond Proceeds—The money paid to the issuer by the purchaser or underwriter of a new issue of municipal securities. These moneys are used to finance the project or purpose for which the securities were issued and to pay certain costs of issuance as may be provided in the bond contract.

Broker—Someone who brings buyers and sellers together and is compensated for his/her service.

Collateralization—Process by which a borrower pledges securities, property, or other deposits for the purpose of securing the repayment of a loan and/or security.

Commercial Paper—An unsecured short-term promissory note issued by corporations, with maturities ranging from 2 to 270 days.

County Pooled Investment Funds—The aggregate of all funds from public agencies placed in the custody of the County Treasurer or Chief Finance Officer for investment and reinvestment.

Coupon—The annual rate of interest that a bond's issuer promises to pay the bondholder on the bond's face value; a certificate attached to a bond evidencing interest due on a payment date.

Custodian—A bank or other financial institution that keeps custody of stock certificates and other assets.

Dealer—Someone who acts as a principal in all transactions, including buying and selling from his/her own account.

Defeased Bond Issues—Issues that have sufficient money to retire outstanding debt when due so that the agency is released from the contracts and covenants in the bond document.

Derivative—Securities that are based on, or derived from, some underlying asset, reference date, or index.

Government Accounting Standards Board (GASB)—A standard-setting body, associated with the Financial Accounting Foundation, which prescribes standard accounting practices for governmental units.

Guaranteed Investment Contracts (GICs)—An agreement acknowledging receipt of funds for deposit, specifying terms for withdrawal, and guaranteeing a rate of interest to be paid.

Liquidity—An asset that can easily and rapidly be converted into cash without significant loss of value.

Local Agency Investment Fund—A voluntary investment fund open to government entities and certain non-profit organizations in California that is managed by the State Treasurer’s office.

Local Government Investment Pool (LGIP)—Investment pools that range from the State Treasurers Local Agency Investment Fund (LAIF) to county pools, to Joint Powers Authorities (JPAs). These funds are not subject to the same SEC rules applicable to money market mutual funds.

Market Value—The price at which a security is trading and presumably could be purchased or sold at a particular point in time.

Maturity—The date on which the principal or stated value of an investment becomes due and payable.

Medium-Term Note—Corporate or depository institution debt securities meeting certain minimum quality standards (as specified in the California Government Code) with a remaining maturity of five years or less.

Mutual Funds—An investment company that pools money and can invest in a variety of securities, including fixed-income securities and money market instruments.

Note—A written promise to pay a specified amount to a certain entity on demand or on a specified date.

Par Value—The amount of principal that must be paid at maturity. Also referred to as the face amount of a bond, normally quoted in \$1,000 increments per bond.

Principal—The face value or par value of a debt instrument, or the amount of capital invested in a given security.

Prospectus—A legal document that must be provided to any prospective purchaser of a new securities offering registered with the SEC that typically includes information on the issuer, the issuer’s business, the proposed use of proceeds, the experience of the issuer’s management, and certain certified financial statements (also known as an “official statement”).

Portfolio—Combined holding of more than one stock, bond, commodity, real estate investment, cash equivalent, or other asset. The purpose of a portfolio is to reduce risk by diversification.

Prudent Investor Standard—A standard of conduct where a person acts with care, skill, prudence, and diligence when investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing funds. The test of whether the standard is being met is if a prudent person acting in such a situation would engage in similar conduct to ensure that investments safeguard principal and maintain liquidity.

Repurchase Agreements—An agreement of one party (for example, a financial institution) to sell securities to a second party (such as a local agency) and simultaneous agreement by the first party to repurchase the securities at a specified price from the second party on demand or at a specified date.

Reverse Repurchase Agreements—An agreement of one party (for example, a financial institution) to purchase securities at a specified price from a second party (such as a public agency) and a simultaneous agreement by the first party to resell the securities at a specified price to the second party on demand or at a specified date.

Rule G-37 of the Securities Rulemaking Board—Federal regulations to sever any connection between the making of political contributions and the awarding of municipal securities business.

Safekeeping Service—Offers storage and protection of assets provided by an institution serving as an agent.

Securities and Exchange Commission (SEC)—The federal agency responsible for supervising and regulating the securities industry.

Securities Lending Agreement—An agreement of one party (for example, a local agency) to borrow securities at a specified price from a second party (for example, another local agency) with a simultaneous agreement by the first party to return the security at a specified price to the second party on demand or at a specified date. These agreements generally are collateralized and involve a third-party custodian to hold the securities and collateral. Economically similar to reverse-repurchase agreement.

Tax and Revenue Anticipation Notes (TRANS)—Notes issued in anticipation of receiving tax proceeds or other revenues at a future date.

Trustee or trust company or trust department of a bank—A financial institution with powers to act in a fiduciary capacity for the benefit of the bondholders in enforcing the terms of the bond contract.

Underwriter—A dealer which purchases a new issue of municipal securities for resale.

US Treasury Obligations—Debt obligations of the United States Government sold by the Treasury Department in the forms of Bills, Notes, and Bonds. Bills are short-term obligations that mature in 1 year or less and are sold on the basis of a rate of discount. Notes are obligations that mature between 1 year and 10 years. Bonds are long-term obligations that generally mature in 10 years or more.

Weighted Average Maturity (WAM)—The average maturity of all the securities that comprise a portfolio that is typically expressed in days or years.

Yield—The current rate of return on an investment security generally expressed as a percentage of the securities current price.

Yield Curve—A graphic representation that shows the relationship at a given point in time between yields and maturity for bonds that are identical in every way except maturity.